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No. 84-1737

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA

Petitioner

v.

THE AMERICAN COLLEGE OF PHYSICIANS

Respondent

On Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

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BRIEF FOR THE AMERICAN MEDICAL ASSOCIATION AND THE MASSACHUSETTS MEDICAL SOCIETY AS AMICI CURIAE IN SUPPORT OF RESPONDENT

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QUESTION PRESENTED

Is publication in the journal of a tax-exempt medical society, one purpose of which is medical education, of advertisements for items used in the practice of medicine, most of which pertain to pharmaceutical products and contain extensive prescribing information mandated by regulations of the Food and Drug Administration, "substantially related to" the tax-exempt purposes of such society, so that income received by the society from such advertisements is not subject to the tax on "unrelated business income" imposed by Sections 511-513 of the Internal Revenue Code?

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INTEREST OF AMICI CURIAE

Amici American Medical Association ("AMA") and Massachusetts Medical Society submit this brief with the written consent of all parties, copies of which consents are being filed herewith. Amicus AMA is a national, voluntary non-profit organization of physicians. AMA was founded in 1846 to promote the science and art of medicine and the betterment of public health. AMA is exempt from Federal income tax under Internal Revenue Code Section 501(c)(6).

Like the respondent in this case, AMA publishes scholarly medical journals in furtherance of its exempt purposes. In addition to scholarly articles, such journals contain display advertising for prescription drugs, books, continuing medical education and medical equipment and classified advertising primarily for medical positions.

AMA has pending in the United States District Court for the Northern District of Illinois (Civil No. 82-C-7213) a case raising the issue presented in this case. AMA believes that its situation is similar to that of respondent and that the decision in this case will affect the result of AMA's litigation and consequently AMA's future publishing operations.

Amicus Massachusetts Medical Society (the "Society") is a non-profit, special act corporation organized and existing under the laws of the Commonwealth of Massachusetts since 1781. It is the oldest American medical association in continuous existence. Approximately 70% of the physicians registered to practice medicine in the Commonwealth of Massachusetts are members of the Society, which is the primary professional physicians' organization in Massachusetts. Among its principal concerns are promoting progress and improvement in the care, treatment and cure of patients. The Society is exempt from Federal income tax under Internal Revenue Code Section 501(c)(6).

The charter of the Society directs it to engage in the publication and distribution of journals and periodicals to be devoted primarily to the science and practice of medicine, and to conduct educational programs. Since 1921, the Society has published *The New England Journal of Medicine*. The *New England Journal* contains, in addition to scholarly articles on medicine, advertising similar to that in the publications of respondent; consequently the Society believes that the decision in this case will substantially affect its taxability under the Internal Revenue Code.

SUMMARY OF ARGUMENT

The Internal Revenue Code has always implemented a policy of exempting from taxation the income received by certain defined organizations thought to promote desirable social goals. Internal Revenue Code, § 501. Section 511 of the Internal Revenue Code, however, applies an unrelated business income tax to activities of such tax-exempt organizations which are "not substantially related" to the organizations' tax-exempt purposes. This "not substantially related" test, which appears in Section 513(a) of the Code, was enacted in 1950 and has never been amended. Thus, as in *Tennessee Valley Authority v. Hill*, 437 U.S. 153 (1978), and *Securities and Exchange Commission v. Sloan*, 436 U.S. 103 (1978), the Court in construing the test should place principal reliance upon the legislative history of the 1950 enactment and not, as petitioner urges, on later Congressional action that did not alter the test. It is clear from the legislative history of the 1950 enactment that Congress did not intend to change the non-taxable nature of traditional sources of income of tax-exempt organizations which had some relationship to the organizations' tax-exempt purposes. The general provisions of the Treasury Regulations, and Internal Revenue Service rulings in areas other than advertising, remain true to this intent.

The advertising in the journal of respondent American College of Physicians plainly meets the "substantially related" test as it was intended to be applied by the Congress that enacted it. Advertising in scholarly journals was a traditional means of raising income by tax-exempt medical societies at the time the unrelated business income tax was passed. And the advertising in respondent's journal, which relates primarily to pharmaceutical products and contains extensive prescribing information in a

complete and balanced format mandated by the Food and Drug Administration, unquestionably furthers in a substantial way respondent's purpose of providing medical education to its members.

Treasury Regulations directed to advertising income of tax exempt organizations which were adopted in 1967, some seventeen years after Congress enacted what is now Section 513(a), do not make respondent's advertising income taxable. The part of those Regulations which petitioner argues has such effect, Example 7 to Treas. Reg. § 1.513-1(d)(4)(iv), is addressed to advertising "designed and selected in the manner of ordinary commercial advertising." Pharmaceutical advertising of the type published by respondent, containing extensive mandated prescribing information of considerable educational value to physicians, is not "ordinary commercial advertising." Moreover, to the extent that Example 7 purports to make a conclusive presumption that any advertising "designed and selected in the manner of ordinary commercial advertising" is "not substantially related" to an organization's tax-exempt purposes, it is inconsistent with both the generally applicable provisions of the Regulations and the purpose and intent of Section 513(a) and must be held invalid.

Nor do the enactment of Section 513(c) of the Internal Revenue Code as part of the Tax Reform Act of 1969 or the legislative history of such enactment provide a ground for taxing respondent's advertising income. Section 513(c) itself does no more than permit application of the "not substantially related" test of Section 513(a) to a single "activity . . . carried on within a larger aggregate of similar activities;" it does not change the test in any way. Although the House and Senate Reports on the Tax Reform Act of 1969 express the opinion that adver-

tising by tax-exempt organizations is taxable, that opinion is couched in general terms and does not apply to highly educational advertising of the type published by respondent. On the contrary, a report by the staffs of the committees which considered the 1969 legislation expressly recognizes that "technical comment" in a pharmaceutical advertisement must be separated from "pure advertising." Staffs of the Joint Comm. on Taxation and the Senate Finance Comm., 91st Cong., 1st Sess., Summary of H.R. 13270, Tax Reform Act of 1969, Aug. 18, 1969, p. 31 (Comm. Print). In any event, as this Court has observed in such cases as *United States v. Price*, 361 U.S. 304, 313 (1960), statements in committee reports of a later Congress are of little value in construing a statute enacted by another Congress some nineteen years earlier.

The commercial nature of respondent's advertising is not relevant to the taxability of the income it produces. Petitioner concedes that respondent's subscription income "is unquestionably exempt from tax" notwithstanding the similarity of respondent's journals to commercial periodicals. Nor does administrative convenience require dispensing with a case-by-case examination of advertising to determine whether it is related to an organization's tax-exempt purpose. The Internal Revenue Service follows a case-by-case approach with respect to other activities of such organizations, without disabling effects.

The Court of Appeals correctly applied the letter and the intent of Section 513(a) of the Internal Revenue Code in this case, and its decision should be affirmed.

ARGUMENT

I.

THE ADVERTISING REVENUES OF RESPONDENT THE AMERICAN COLLEGE OF PHYSICIANS ARE NOT TAXABLE UNDER THE PLAIN LANGUAGE OF SECTION 513(a) OF THE INTERNAL REVENUE CODE, THE LEGISLATIVE HISTORY OF THAT SECTION, AND THE REGULATIONS, RULINGS AND DECISIONS APPLYING THAT SECTION TO OTHER ACTIVITIES.

The Internal Revenue Code has always exempted from taxation certain defined kinds of organizations thought to perform useful social functions. Internal Revenue Code, Section 501. Respondent has qualified for exemption under this section, and the Court of Appeals held that this exemption prevents taxation of the income received by respondent from advertisements published in its medical journals. Petitioner contends that such income falls within an exception to the exemption contained in Sections 511 through 513 of the Internal Revenue Code, which impose what is known as the unrelated business income tax. Petitioner's contention ignores the history and prior application of the unrelated business income tax and the very substantial contribution respondent's advertising makes to the education of its members.

A. Income-Producing Activities Of A Tax-Exempt Organization Are "Substantially Related" To Its Tax-Exempt Purposes, And Thus Not Taxable, If They Contribute To The Achievement Of Such Purposes, Regardless Of Whether They Are Carried On In The Manner Of An Ordinary Commercial Business.

The unrelated business income tax, now codified at Internal Revenue Code Sections 511 through 513, 26 U.S.C. §§ 511-513, was enacted in the Revenue Act of 1950, ch. 994, § 301, 64 Stat. 947. These provisions impose a tax upon the income, derived by an organization otherwise

exempt from Federal income tax, from a "trade or business the conduct of which is *not substantially related* . . . to the exercise or performance by the organization of its [exempt purposes]." Section 513(a) (emphasis supplied).

Although one of several concerns resulting in enactment of the unrelated business income tax was "unfair competition", *see, e.g.*, H.R. Rept. No. 2319, 81st Cong., 2d Sess., at 36 (1950),[1] the statutory requirement for taxability is that the income "is not substantially related" to the exempt purposes of the organization. Thus, under the plain language of the statute, *neither* the existence of competition *nor* the ordinary commercial character of the business is the touchstone for imposition of the tax.

The "not substantially related" test of Section 513(a) has never been amended since its enactment in 1950. The Tax Reform Act of 1969, upon which petitioner places so much reliance, made it possible to apply the test to a single "activity . . . carried on within a larger aggregate of similar activities" by adding Section 513(c) to the Code, *but it did not change the test.* See page 22, *infra*. Thus it is the 1950 statute, its legislative history, and rulings under it that principally determine what sorts of "activities" are subject to the unrelated business income tax. The inquiry the Court must make here is not unlike that it made in *Tennessee Valley Authority v. Hill*, 437 U.S. 153 (1978), and *Securities and Exchange Commission v. Sloan*, 436 U.S. 103, 119-121 (1978), in which the Court concluded that the legislative history produced by the Congress which passed the statute in question was far

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[1] This report places its discussion of the unrelated business income tax in a section entitled "Sources of Additional Revenue." *Id.* at 24.

more pertinent in ascertaining the statute's meaning than reports issued by subsequent Congresses which had not amended the statute.

1. The Legislative History Of The Revenue Act Of 1950 Demonstrates That Congress Did Not Intend To Tax Activities "Customarily Carried On" By A Tax Exempt Organization Which Had Some Relationship To The Organization's Tax-Exempt Purposes.

When Congress enacted the unrelated business income tax in 1950, it did not mean to alter significantly the traditional treatment of tax-exempt organizations. From its genesis, the unrelated business income tax was intended to apply only to income-producing activities of a tax-exempt organization which bore little or no relation to the organization's exempt activities.[2] In his message to Congress transmitting a request for a revision of tax laws, President Truman criticized the existing "exemption . . . misused in a few instances to gain competitive advantage over private enterprise through the conduct of business and industrial operations *entirely unrelated* to educational activities." *Revenue Revision of 1950: Hearings Before the House Comm. on Ways and Means*, 81st Cong., 2d Sess. at 4 (1950) (hereinafter cited as *1950 House Hearings*) (emphasis supplied).

Testimony of Treasury representatives at the 1950 hearings before both the House Ways and Means and the Senate Finance Committees emphasized that the new tax

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[2] The paradigm example of such activities was the ownership by New York University of the C.F. Mueller Company, a macaroni manufacturer. It was noted in Congressional debates that "there is nothing in the charter of that university, nor is there anything in its curriculum that is even remotely connected with the manufacture of spaghetti . . . ." 96 Cong. Rec. 9366, June 28, 1950 (remarks of Congressman Lynch).

was directed at unusual and clearly unrelated activities. Treasury Secretary Snyder stated before both Committees that the unrelated business tax would apply to business operations of exempt organizations that were "*clearly unrelated*" to their exempt purposes (emphasis supplied), such as "the manufacture of food products, leather goods, vegetable oils, and the distribution of petroleum products," but that "[t]he bill would not tax their income from related activities . . . customarily carried on by educational and charitable organizations." *1950 House Hearings* at 19; *Revenue Revisions of 1950: Hearings on H.R. 8920 Before the Senate Finance Comm.*, 81st Cong., 2d Sess. (1950) at 7 (hereinafter cited as *1950 Senate Hearings*). Vance Kirby, Tax Legislative Counsel of the Treasury, complained of business operations bearing "no relation" to the tax exempt purposes of the organization, and assured the Committee that "traditional sources of income" would remain tax exempt. *1950 House Hearings* at 165.

Similarly, the reports of the legislative committees on the bill which became the Revenue Act of 1950 demonstrate that Congress intended to tax unusual sources of income, but to leave untaxed the usual and traditional sources of income for tax-exempt organizations where some relationship with its tax-exempt purpose existed. Thus income received by a college "from charges for admissions to football games" would be related, but "the manufacture and sale of automobile tires . . . would ordinarily be considered an unrelated business." H.R. Rept. No. 2319, 81st Cong., 2d Sess. at 109 (1950); *accord* S. Rept. No. 2375, 81st Cong., 2d Sess. at 107 (1950).

This great a contrast between activities given for examples cannot have been accidental. Although a football game has some relationship to a college's educational purpose, education is not its predominant function. But this

and other traditional sources of support were to be excluded from the unrelated business tax. Manufacturing tires is not a traditional activity, and hence would be subject to tax.

This theme was continued in the floor debates on the Revenue Act of 1950. In debate, legislators stated that the unrelated business income tax was directed at businesses which were "totally unrelated" and not "even remotely connected" with the exempt purposes of the organization. 96 Cong. Rec. 9366, June 28, 1950 (remarks of Congressman Lynch). The unrelated business income tax was directed at exempt organizations which operated "businesses wholly unrelated to the purposes" for which the organizations were chartered, and was to apply in situations where "[t]here is no possible connection between some of the operations and the normal activities of these institutions." *Id.* at 9365. Other statements were to the effect that the statute was directed at abuses in which an organization "would, in effect, sell its tax exemption, and would go into some business unrelated entirely with the purpose" of the organization. *Id.* at 9364 (remarks of Congressman Simpson). Furthermore, the unrelated business income tax was to be imposed "only after being certain that no harm would be done to legitimate operations." *Id.* at 9365 (remarks of Congressman Lynch).

In light of the foregoing, and in the absence of any suggestion in the 1950 legislative history of a more stringent definition of "substantially related," the Court of Claims correctly concluded in 1976 that:

> The 1950 Act was a fairly limited measure, designed to distinguish the customary activities of exempt organizations from the operation of independent business enterprises *entirely unrelated* to the educational purpose of the organization.

American College of Physicians v. United States, 530 F.2d 930, 933 (Ct. Cl. 1976) (emphasis supplied). Congress had no intention when it enacted the Revenue Act of 1950 of taxing such traditional activities as advertising in professional journals of tax-exempt organizations when that advertising bore some relationship to the purposes of the organization. *See* Note, *The Macaroni Monopoly: The Developing Concept of Unrelated Business Income of Exempt Organizations*, 81 Harv. L. Rev. 1280, 1291 (1968). And no attempt was made to tax such advertising under the 1950 statute for seventeen years after the statute was enacted.

2. Generally Applicable Treasury Regulations, Internal Revenue Service Rulings Thereunder With Respect To Activities Other Than Advertising, And Lower Court Decisions All Recognize The Broad Definition Of "Substantially Related" Activities Which Congress Intended.

The generally applicable Treasury regulations promulgated under Sections 511 through 513 recognize the nature of the statutory test. They state that business activities are not subject to the unrelated business income tax "where the conduct of the business activities has causal relationship to the achievement of exempt purposes" and where such activities "contribute importantly" to the accomplishment of those exempt purposes. Treas. Reg. § 1.513-1(d)(2), set out at Pet. App. 47a-48a. The regulations further state that resolution of the issue "depends in each case upon the facts and circumstances involved." *Id.*

Decisions of the Internal Revenue Service in areas *other* than advertising recognize the exempt nature of income from traditional activities of a tax exempt organization even though such activities are carried on in the manner of an ordinary commercial business, where there is some

relationship to the organization's tax-exempt purposes. In Revenue Ruling 73-104, 1973-1 C.B. 263, income obtained by an art museum from the sale of greeting cards displaying reproductions of selected works from the museum's collection and other collections, which were sold in a shop operated in the museum, by mail order through a catalog published by the museum, and to retail stores at quantity discounts, was held to be non-taxable. The ruling states that "[t]he fact that the cards are promoted and sold in a clearly commercial manner at a profit and in competition with commercial greeting card publishers does not alter the fact of the activity's relatedness to the museum's exempt purpose." 1973-1 C.B. at 264.

Similarly, the operation by a museum of a restaurant, Revenue Ruling 74-399, 1974-2 C.B. 172, and the operation by a hospital of a gift shop, a cafeteria and coffee shop, and a parking lot, Revenue Rulings 69-267, 69-268 and 69-269, 1969-1 C.B. 160-61, all are related activities, even though such activities are conducted to raise revenue and are operated in the manner of ordinary commercial establishments.

Of particular relevance here is Revenue Ruling 75-516, 1975-2 C.B. 220, presenting the issue whether income which an organization exempt under Section 501(c)(6) derives from the rental of display space at its convention "to exhibit and demonstrate products and services used by the [organization's] members in their businesses" is related or unrelated income. The Ruling holds that "[t]he display and presentation of instructional material concerning the common business interests of the members, as part of an annual membership convention, contribute importantly to the advancement of the organization's exempt purpose" of "imparting general information to members about changing business conditions and the availability of new products and services" and that income derived therefrom is

"related" and not taxable. Thus, income received by a tax-exempt medical society from exhibitors of medical products at its conventions is not taxable, even though such exhibitors disseminate to physicians attending the conventions materials that are identical to the advertisements placed by such exhibitors in medical journals.[3]

Furthermore, in instances in which the Internal Revenue Service attempted to extend the unrelated business income tax to traditional sources of support of tax-exempt organizations, those efforts were rejected by the courts. *Maryland State Fair and Agricultural Society, Inc. v. Chamberlin*, 55-1 U.S. Tax Cas. (CCH) ¶ 9399 (D. Md. 1955) (horse racing "customary" and conducted "habitually" in conjunction with fair); *Mobile Arts and Sports Association, Inc. v. United States*, 148 F. Supp. 311 (S.D. Ala. 1957) (Senior Bowl football game an "integral part" of organization's civic and educational program).

More recent decisions of lower courts construing the provisions of the unrelated business income tax also have uniformly considered the presence or absence of a substantial relationship between the activity and the organization's exempt purposes to be the sole determinant of taxability. *Hi-Plains Hospital v. United States*, 670 F.2d 528 (5th Cir. 1982); *San Antonio Bar Association v. United States*, 80-2 U.S. Tax Cas. (CCH) ¶ 9594 (W.D. Tex. 1980). "The regulations [Treas. Reg. § 1.513-1(d)] require a case-by-case identification of the exempt purpose, an analysis of how the activity contributes to that purpose and an

[3] Section 513(d), effective October 4, 1976, now expressly provides that qualified trade show activities, including activities described in Revenue Ruling 75-516, do not give rise to unrelated business income. The Internal Revenue Service on August 12, 1985 declared Revenue Ruling 75-516 obsolete in light of Section 513(d). Rev.Rul. 85-123, 1985-32 I.R.B. 8.

examination of the scale on which the activity is conducted." *Hi-Plains Hospital, supra*, 670 F.2d at 531. The question of whether an activity contributes importantly to an organization's exempt purpose must be considered "in light of the particular facts and circumstances of [the organization's] case." *Id.*

B. Respondent's Advertising Is "Substantially Related" To Its Tax-Exempt Purpose Of Providing Medical Education Within The Meaning Of Section 513(a) And Is Thus Not Taxable.

Respondent's exempt purposes, as conceded by petitioner, are:

> "(1) to uphold and to maintain high standards in medical education, medical practice and medical research, (2) to encourage research, especially in clinical medicine, and (3) to foster measures for the prevention of disease and for the improvement of public health."

J.A. 16a. In furtherance of its exempt purposes respondent publishes *Annals of Internal Medicine*, which since 1927 has contained both scholarly articles relevant to the practice of internal medicine and advertisements relating only to medical products, 80 percent of which are for prescription drugs.

This is not "garden variety commercial" advertising. The contents of advertisements for prescription drugs are dictated by the Food and Drug Administration. FDA regulations, 21 C.F.R. Part 202, require such advertising to contain detailed information as to the composition of the drug, its indications, contraindications, precautions, side effects, effectiveness and dosage. A prescription drug advertisement thus constitutes a mini-article about the advertised drug and has substantial educational value in its own right.

The uncontested testimony of respondent's witnesses at the trial in this case establishes that drug advertising fulfills an *important* educational function.

Respondent's witnesses testified that "[t]he sophisticated decision of when to use and not use drugs" is "at the very heart of internal medicine," J.A. 43a (testimony of Dr. Stewart Bondurant, Dean of the School of Medicine of the University of North Carolina), and that it is essential for a physician to keep up with developments in drugs.

The "use of journals" is "one of the keystones of a personal program of continuing education," J.A. 44a (testimony of Dr. Bondurant). The use of journals includes the review of advertisements. "[I]t's especially important that . . . the editorial content be looked at in a sort of point-counterpoint relationship with the advertising in [respondent's] Journal, because neither one alone would give a practicing physician a full basis of knowledge about using the drug." J.A. 38a (testimony of Dr. Louis Lasagna, Professor of Pharmacology and Medicine at the University of Rochester School of Medicine). Dr. Bondurant also testified as to the educational value of drug advertising, stating that "[t]he material in the advertisements serves in a very effective way . . . as an alerting function," J.A. 43a, and that such advertising complements the scientific portion of the journal. *Id.*

The educational value of drug advertising has been noted elsewhere. In testimony before the Monopoly Subcommittee of the Select Committee on Small Business of the United States Senate on August 10, 1967, Dr. James L. Goddard, who was then Commissioner of the Food and Drug Administration, stated that the purpose of proposed new FDA regulations specifying the contents of prescription drug advertising was "to get [drug companies] to

adopt the basic concept that drug advertising is educational and thus should be truthful, that it differs from advertising of motor vehicles and other items in our economy, that there is a special significance here." Dr. Goddard further testified before the Subcommittee on that date as follows:

> Medical advertising has been cited before this committee as one of the forms of continuing education of the doctor. I would agree with this appraisal, for—whether good or bad—industry spends some $3,000 per year per doctor on promotion. I have described to you our attempts to assure better medical advertising. We will continue to strengthen our monitoring of such advertising.

Competitive Problems in the Drug Industry: Hearings Before the Subcomm. on Monopoly of the Senate Select Comm. on Small Business, 90th Cong., 1st Sess. at 749 and 821 (1967).

The advertising in respondent's journal is required by law to be educational. It is sought out and used for its educational content by physicians as part of their continuing education. It complements the editorial content of respondent's journal and respondent's other educational programs. Such advertising therefore "contributes importantly" to respondent's exempt educational purpose and, under the standard of Section 513(a), is substantially related to such purpose. The income from such advertising is not unrelated business income.

II.

THE ARGUMENTS ADVANCED BY THE UNITED STATES FOR DEPARTING FROM THE PLAIN LANGUAGE OF SECTION 513 OF THE INTERNAL REVENUE CODE IN THIS CASE ARE WITHOUT MERIT.

Petitioner urges reversal of the decision below principally upon the grounds (1) that Treasury Regulations adopted in 1967 set forth a "per se rule" or "blanket rule" that all advertising is taxable (Pet. Brf., pp. 11-18, 27-28), and (2) that Congress in 1969 specifically approved this "per se rule" (*Id.* at 18-26). Petitioner also argues that reversal of the decision below is supported by considerations of administrative convenience and the commercial purpose and effects of respondent's advertising (Pet. Brf., pp. 41-43). None of these arguments is sufficient to overcome the plain language of Section 513(a) and the clear intent of Congress in enacting that provision.

A. Taxation Of Respondent's Advertising Revenues Is Not Justified By The 1967 Treasury Regulations.

Petitioner derives its "per se rule" from language in Example 7 to Treasury Regulation § 1.513-1(d)(4)(iv), adopted in 1967, which states that a professional association's publication of advertising "designed and selected in the manner of ordinary commercial advertising is not an educational activity." Pet. App. 52a-53a. In so doing petitioner fails to take into account the remaining language of Example 7, which clearly distinguishes the advertisements hypothesized there from those of respondent. Petitioner also fails to give sufficient weight to the relevant, generally applicable substantive provision of Treasury Regulation § 1.513-1(d)(2), stating that activities are "substantially related" to an organization's tax-exempt purposes if they "contribute importantly to the accomplishment of those purposes," and that whether given activities

meet this test "depends in each case upon the facts and circumstances involved." In light of the full language of the Treasury Regulations, and in light of the language and purpose of Section 513(a) of the Internal Revenue Code, Example 7 simply cannot be construed to impose a tax on respondent's advertising. If it were so construed, it would plainly be invalid.[4]

1. The Language Of Example 7 Of The Regulations Does Not Impose A Tax On The Advertising Revenues Of Respondent.

Example 7 to Treasury Regulation § 1.513-1(d)(4)(iv) does not create a "per se rule" applicable to advertising of the type published by respondent. This example does nothing more than apply the substantial relationship test to a set of hypothetical "facts and circumstances" that differs greatly from the present case. In Example 7 the "form, content, and manner of presentation of the advertising messages are governed by the basic objective of the advertisers to promote the sale of the advertised products," and "the informational function of the advertising is incidental to the controlling aim of stimulating demand for the advertised products and differs in no essential respect from the informational function of any commercial advertising."

By contrast, the advertisements at issue in the present case, which are primarily advertisements for prescription

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[4] Respondent, an organization exempt under Section 501(c)(3) of the Internal Revenue Code, contends that Example 7 is not at issue here because the Example by its terms is applicable only to organizations exempt under Section 501(c)(6) of the Code. Amici, as organizations exempt under Section 501(c)(6), take no position with respect to this contention of respondent. Amici wish to note, however, that Example 7 expressly recognizes that an organization exempt under Section 501(c)(6) may have as one of its tax-exempt purposes the "continuing education of its members in matters pertaining to their profession."

drugs,[5] are quite different in several respects. Advertisements for prescription drugs are *not* "designed and selected in the manner of ordinary commercial advertising." No less an authority than the Commissioner of the Food and Drug Administration has testified before Congress that drug advertising "differs from advertising of . . . other items in our economy." *See* pages 15-16, *supra*. The "form, content, and manner of presentation" of such advertising are not "governed by the basic objective of the advertisers to promote the sale of the advertised products." Rather, they are closely regulated by the Food and Drug Administration. Drug advertisements contain detailed and essential information mandated by Section 502(n) of the Food, Drug and Cosmetic Act, 21 U.S.C. § 352(n), and regulations of the FDA thereunder, codified at 21 C.F.R. Part 202. These advertisements are used by physicians as an integral part of their continuing education, J.A. 38a, 43a, and in fact are actively sought out by physicians to enhance and update their medical knowledge. The informational function of such advertising is not, as in the case of the advertising in Example 7, merely "incidental;" it is substantial and it contributes importantly to respondent's exempt educational purpose.

In order to make Example 7 apply to respondent's advertising, petitioner is forced to argue that the intent of the Example is to declare *all* advertising in professional journals to be taxable (Pet. Brf., p. 27). Such a construction is plainly inconsistent with the statement in Treas. Reg. § 1.513-1(d)(2) that the "facts and circumstances" of "each case" must be examined. Furthermore, if this had been the intent of the regulations, it is wholly

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[5] Much of respondent's non-drug advertising is for medical employment opportunities. This is also outside the scope of Example 7, which relates to "products."

improbable that the rule would have been stated in the context of a factually-oriented Example. Indeed, if the Treasury Department had intended to tax all advertising revenues received by professional journals, it would not have bothered to issue Examples 6 and 7 at all.

2. If Example 7 Of The Regulations Were Construed As Urged By Petitioner, It Would Be Invalid Because Of Its Inconsistency With The Statute And The Substantive Provisions Of The Regulations.

To the extent Example 7 purports to declare *any* kind of advertising income taxable merely because the advertising is "designed and selected in the manner of ordinary commercial advertising," the Example must be held invalid. The comparability of an activity of a tax exempt organization to "ordinary commercial" activities is simply not determinative of whether the activity is "substantially related" to the purposes of the organization within the meaning of Section 513(a) of the Code. The legislative history of Section 513(a) and Internal Revenue Service rulings under that Section contain countless examples of activities held to be "substantially related" despite being conducted in an "ordinary commercial" manner, such as college football games, museum gift shops, and hospital cafeterias. *See* pages 9, 11-13, *supra*. Moreover, such a reading of Example 7 brings it into direct conflict with the substantive provisions of Treas. Reg. § 1.513-1(d)(2).

Example 7 is part of an interpretive regulation promulgated under Section 7805(a) of the Internal Revenue Code. As such, it is not entitled to the same deference as a regulation issued under a specific grant of authority to the Commissioner of Internal Revenue. *United States v. Vogel Fertilizer Co.*, 455 U.S. 16, 24 (1982). It was, moreover, adopted some 17 years after the statute it purports to interpret, and thus hardly constitutes a "contemporane-

ous construction" of that statute. Finally, because it is an example and not a substantive regulation, it constitutes little more than an advisory opinion issued on a truncated set of hypothetical facts.

In light of the foregoing, whatever presumptions may normally exist in favor of a Treasury Regulation (Pet. Brf., p. 33) do not save Example 7 as construed by petitioner. This Court has repeatedly held that "[a] regulation which . . . operates to create a rule out of harmony with the statute, is a mere nullity." *Manhattan General Equipment Co. v. Commissioner*, 297 U.S. 129, 134 (1936); *see also, Commissioner v. Acker*, 361 U.S. 87, 92 (1959). "[W]here . . . the provisions of the [statute] are unambiguous, and its directions specific, there is no power to amend it by regulation." *Koshland v. Helvering*, 298 U.S. 441, 447 (1936). Recent decisions of this and other courts have not hesitated to invalidate interpretations of the tax laws by the Treasury Department containing infirmities similar to those present here. *See, e.g., Commissioner v. Engle*, 464 U.S. 206 (1984); *United States v. Vogel Fertilizer Co.*, 455 U.S. 16 (1982); *United States v. Cartwright*, 411 U.S. 546 (1973); *Jones v. Commissioner*, 743 F.2d 1429 (9th Cir. 1984); *State of Washington v. Commissioner*, 692 F.2d 128 (D.C. Cir. 1982); *American Standard, Inc. v. United States*, 602 F.2d 256 (Ct. Cl. 1979).

B. Taxation Of Respondent's Advertising Revenues Is Not Justified By The 1969 Amendment Or The Legislative History Of That Amendment.

Petitioner argues that Section 513(c), which was added to the Internal Revenue Code as part of the Tax Reform Act of 1969, and the legislative history of that provision support its contention that respondent's advertising is per se taxable. Section 513(c) plainly has no such effect, and reports of Congressional committees in 1969 do not and cannot alter the meaning of Section 513(a) as enacted in 1950.

1. Section 513(c) Does Not Apply A Per Se Rule To Tax Advertising Revenues Of The Type Involved In This Case.

Prior to the enactment of Section 513(c), a single component of a "trade or business" which, considered in its entirety, was related to an organization's exempt purpose was not subject to the unrelated business income tax. *See American College of Physicians v. United States*, 530 F.2d 930 (Ct. Cl. 1976); *Massachusetts Medical Society v. United States*, 514 F.2d 153 (1st Cir. 1975). Section 513(c) merely removed this impediment to the taxation of a component of an overall exempt activity when that component was "not substantially related" to the organization's exempt purpose. *Section 513(c) does not, however, address whether a component of an overall activity is related or unrelated.* It merely treats such component as a separate trade or business. Each component must then be tested under the standard of Section 513(a).

Congress undoubtedly could have made all advertising taxable, but it did not do so. Instead, it enacted a broad rule applicable equally to *all* activities of tax-exempt organizations, not just advertising. Thus, the analysis of the advertising content of a medical journal to determine whether or not such advertising is substantially related to the organization's exempt purposes is the same as the analysis involved in any case in which an overall activity consists of two or more severable activities. *See Hi-Plains Hospital v. United States*, 670 F.2d 528 (5th Cir. 1978) (sales of prescription drugs by hospital pharmacy to patients of hospital (related), to patients of hospital staff physicians (related), and to public (unrelated)—sale-by-sale analysis required). Such an analysis is precisely what the Court of Appeals undertook in this case.

2. The Legislative History Of Section 513(c) Does Not Indicate An Intent To Tax Advertising Revenues Of The Type Involved In This Case.

In its brief, petitioner suggests that the legislative history to the 1969 amendment demonstrates Congress' intent to adopt the per se rule advanced by petitioner. This is not true.

The bulk of the comments regarding Section 513(c) in both the House and Senate Reports on the Tax Reform Act of 1969 relate to the specific effect of that Section, i.e., "that an activity is not to lose its identity as a trade or business merely because it is carried on within a larger aggregate of similar activities." H.R. Rept. No. 413, 91st Cong., 1st Sess. Pt. 1, at 50 (1969). To the extent the Reports refer to the 1967 Treasury Regulations on advertising income or the "relatedness" requirement of Section 513(a), they do not evidence an intent to declare all advertising to be taxable.

The reference in the report of the House Ways and Means Committee to the 1967 regulations is qualified, stating only that "[*i*]*n general*, [the committee] is in agreement with the purpose of the regulations." *Id.* (emphasis supplied). Petitioner places great weight on the statement occurring a few lines later in this report to the effect that the committee had concluded that advertising is not related, and therefore should be taxed. Pet. Brf., p. 25. But this conclusion was obviously also meant to be "in general," for the same committee, in the technical explanation portion of its report, further describes the effect of the new Section 513(c) to be that:

> . . . the advertising contained in a publication of an exempt organization *may* be subject to the tax under section 511 even though the editorial content of the publication may be related to the exempt purposes of the organization.

H.R. Rept. No. 413, *supra*, Pt. 2, at 26 (emphasis supplied). The term "may" scarcely denotes a per se rule.

That the House had no intention of taxing advertising of the specific type published by respondent is made clear by the summary of the bill passed by the House which was prepared by the staffs of the Joint Committee on Taxation and the Senate Finance Committee. In listing arguments against the fragmentation approach of Section 513(c) that would require treating advertising as a separate activity, the staffs noted the practical problem created because

> This bill ignores the fact that it is difficult to separate technical comment (such as where technical benefits of a pharmaceutical product is described in an advertisement in a medical journal) from pure advertising.

Staffs of the Joint Comm. on Taxation and the Senate Finance Comm., 91st Cong., 1st Sess., Summary of H.R. 13270, Tax Reform Act of 1969, August 18, 1969, at 31 (Comm. Print). Obviously the staffs of these committees believed that it was necessary to "separate" medical advertising containing "technical comment" such as that in respondent's publications from "pure advertising" before applying the unrelated business income tax; if they had believed income from pharmaceutical advertisements to be taxable, there would have been no reason to consider how "difficult" it was to separate them from "pure advertising."

The report of the Senate Finance Committee, S. Rept. No. 552, 91st Cong., 1st Sess. (1969), quoted by petitioner at Pet. Brf., p. 27, does not strengthen petitioner's argument. The Senate report repeatedly states that "the committee agrees with the House" and that its members "approve the intent of the House provision." *Id.*, at 75. Thus the taxation of advertising approved by the Senate was

subject to the same "in general" qualification—and the same exclusion of "technical comment" advertising—as that approved by the House.

Knowledgeable persons within the Internal Revenue Service itself have not considered the 1969 congressional action to result in the taxation of all advertising, as demonstrated by the statement made in 1976 by an attorney in the Exempt Organizations Technical Branch of the IRS, expressing his own views, that "[t]he question of which advertising, if any, is related may be a fertile area for future litigation." Nonberg, *Taxation of Advertising in Exempt Organization Publications*, Tax Mgmt. Memo. 76-12, at 7 (1976).

3. The 1969 Legislative History Of Section 513(c) Cannot Change The Plain Meaning Of Section 513(a), Enacted In 1950.

Even if the legislative history of Section 513(c) supported petitioner's "per se rule," it would not provide a basis for reversing the application of Section 513(a) by the court below. The only *statutory* change made by Congress in 1969 was the adoption in Section 513(c) of the fragmentation principle. Congress did *nothing* to change Section 513(a), which still must be applied to each of the components of the overall activity. If Congress had intended to decree that all advertising activities are unrelated trades or businesses, it could have done so by simple and clear amendment to the Code. It did not do so.

Congress cannot without amending a statute add something which is not there. *Commissioner v. Acker*, 361 U.S. 87, 93 (1959). In this case Congress did not amend Section 513(a); it merely commented upon Section 513(a) in committee reports. Such reports obviously cannot overrule the language and structure of the statute and are of little value in determining its meaning, especially when

they are made long after the statute's enactment. As stated by the Court in *United States v. Price*, 361 U.S. 304, 313 (1960):

> [T]he views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one.

Accord, Tennessee Valley Authority v. Hill, 437 U.S. 153, 193 (1978); *Securities and Exchange Commission v. Sloan*, 436 U.S. 103, 121 (1978).

Because the intent of Congress in enacting the provisions of Section 513(a) in 1950 is clear, any inconsistent intent expressed in Congressional committee reports some 19 years later is of no effect. If Congress wishes to change the meaning of Section 513(a), it must do so by statutory enactment, not by "legislative history" created years after the fact.

C. Neither The Commercial Nature Of Respondent's Advertising Nor Considerations Of Administrative Convenience Support Taxation Of Respondent's Advertising Income.

Petitioner argues that policy considerations support taxation of respondent's advertising. It contends that because respondent conducts a "commercial advertising business" in competition with other publishers, and because respondent supposedly "was motivated entirely by revenue raising . . . concerns," it should pay tax on its advertising profits "just as any other publisher would have to do." Pet. Brf., pp. 41, 43. The difficulty with this argument is that it has no statutory basis and is flatly inconsistent with the treatment of tax-exempt organizations embodied in the Internal Revenue Code. On numerous occasions the courts and the Internal Revenue Service itself have held that a commercial mode of operation, a revenue-raising purpose, and the existence of commercial competitors do not render taxable an activity related to an organization's tax-exempt purpose. *E.g.*, Rev. Rul. 73-104, *supra* (sale

of greeting cards); Rev. Rul. 74-399, *supra* (operation of restaurant); *San Antonio Bar Association v. United States*, 80-2 U.S. Tax Cas. (CCH) ¶ 9594 (W.D. Tex. 1980) (sale of legal forms); *Edward Orton, Jr. Ceramic Foundation v. Commissioner*, 56 T.C. 147 (1971); *nonacq.* 1972-2 C.B. 4 (sale of pyrometric cones). Indeed, as petitioner admits, the subscription income received by respondent from its supposedly commercially competitive journal "is unquestionably exempt from tax." Pet. Brf., p. 43. The statutory touchstone is the existence of a substantial relationship between the activity and an organization's tax-exempt purpose, and it is the policy of the tax laws to exempt such activities from taxation regardless of how many organizations wish to participate in them.

Petitioner also argues that conducting a case-by-case examination of whether advertising is related "would entail formidable burdens on IRS audit resources". Pet. Brf., p. 42. This, however, is exactly what the IRS does with respect to activities of tax-exempt organizations other than advertising, apparently without disabling effects. *See, e.g., Hi-Plains Hospital v. United States*, 670 F.2d 528 (5th Cir. 1982); Rev. Rul. 73-105, 1973-1 C.B. 264. Moreover, Congress passed Section 513(c) in 1969 despite the concern expressed by the staffs of its committees that "it is difficult to separate technical comment (such as where technical benefits of a pharmaceutical product is described in an advertisement in a medical journal) from pure advertising." Staffs of the Joint Comm. on Taxation and the Senate Finance Comm., 91st Cong., 1st Sess., Summary of H.R. 13270, Tax Reform Act of 1969, August 18, 1969, at 31 (Comm. Print), discussed at page 24, *supra*. Plainly Congress did not have the same worry about "IRS audit resources" that petitioner expresses. In any event, the "bureaucratic convenience" of establishing a "bright-line rule" cannot justify a construction of a Treasury Regula-

tion that produces a result inconsistent with the intent of the Internal Revenue Code provision being applied. *Jones v. Commissioner*, 743 F.2d 1429, 1433 (9th Cir. 1984). *See also Commissioner v. Engle*, 464 U.S. 206, 227 (1984).

CONCLUSION

For the reasons stated herein, the judgment of the Court below should be affirmed.

Respectfully submitted,

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